

Testimony on Mortgage Lending Disparities
Massachusetts Office of the Attorney General
House Committee on Financial Services
October 15, 2007

Good morning. My name is Martha Coakley. I serve as Attorney General of the Commonwealth of Massachusetts. Thank you, Chairman Frank and members of the Financial Services Committee, for this opportunity to address the critical issue of the mortgage lending and foreclosure crisis, and particularly the issue of racial and ethnic disparities in mortgage lending.

I took office in January 2007 amid the rising wave of home foreclosures that continues to have a devastating impact on people and communities across Massachusetts. I immediately set out to take a multifaceted approach, consistent with my role as Attorney General, that comprises at least four prongs: (1) we have initiated several investigations and enforcement actions to hold accountable those who engage in unlawful predatory lending or foreclosure conduct, including lenders, brokers, closing attorneys, appraisers, foreclosure rescue scam artists, or others who crossed the line of fair, lawful lending practices; (2) following hearings across the state, we are promulgating more comprehensive and finely tuned mortgage broker and lender regulations based upon the Attorney General's authority from the Massachusetts Consumer Protection Act; (3) working with the National Consumer Law Center, the Boston Bar Association, and many others, we created a pro bono lawyer referral service so that those facing foreclosure potentially could have access to legal advice that otherwise would be unavailable; and (4) we continue to work with state and federal legislators, regulators and fellow law enforcers locally and nationally to seek solutions for the present lending and foreclosure crisis, and to prevent a recurrence in the future.

We issued an emergency regulation banning foreclosure rescue schemes, which became permanent last month. We will shortly issue a report as a result of our hearings as well as four additional regulations and will forward them to you immediately.

In our efforts we have gone to communities across Massachusetts and have talked with victims of unfair, deceptive and illegal lending practices, as well as those victimized by foreclosure rescue scams. We know that the results and the impact of out-of-control subprime lending practices cross community, racial, and ethnic lines, and many people and communities across Massachusetts have been affected. We also know, however, that minority communities in Boston and elsewhere have been hit particularly hard. There have been almost 1000 home foreclosures in the past 180 days in Boston alone, and these foreclosures have clustered in low-income and minority neighborhoods, particularly in Dorchester, East Boston, Mattapan, Hyde Park, and Roxbury. For example, in Mattapan, which is 77% African American and 13% Latino, from January 2006 to May 2007 there were 160 foreclosures out of a total 479 loans.

2006 HMDA Data

The disproportionate impact of foreclosures on minority communities may be a predictable, but no less disturbing, reflection of the fact that African American and Latino borrowers are more likely to get high-APR loans than their white counterparts, regardless of their income level. This fact has again been confirmed by the Federal Reserve Board, with its release last month of mortgage lending data under the federal Home Mortgage Disclosure Act, or HMDA. Before addressing the 2006 data, I would like to acknowledge the work of Professor Jim Campen and the Massachusetts Community and Banking Council, who have analyzed HMDA lending data for each of the past seven years for Massachusetts and have reported on the rise of subprime lending and racial disparities in the data. As Professor Campen explained in the

January 2007 report, which analyzes the 2005 HMDA data, in Boston, Greater Boston, and Massachusetts as a whole, high-APR loans made up more than half of all home purchase loans to African-American and Latino borrowers. In Greater Boston, the high-APR share for African-Americans is nearly 4 times greater than the share for whites with respect to home purchase loans, and 3 times greater for refinance loans. Among Latino borrowers, the share of high-APR home purchase loans is 4 times higher than for white borrowers, and the share of high-APR refinance loans is 3 times higher. These patterns are present at all income levels, with the racial disparities becoming more pronounced among higher income borrowers. In Boston, only 9.4% of the highest-income white home purchase borrowers received high-APR loans. In contrast, 71.1% of the highest-income Black home purchase borrowers received high-APR loans. The figure was 56.2% for the highest-income Latinos.¹

The 2006 HMDA data released in September indicates similar nationwide trends. According to the Federal Reserve's analysis of the data, high-APR lending is "notably greater" for African-Americans and Latinos than for non-Latino whites.² This analysis of the 2006 HMDA data "revealed substantial differences across racial and ethnic lines in the incidence of higher-priced lending and in denial rates; further it showed that such differences could not be fully explained by factors in the HMDA data."³

The fact of racial and ethnic disparities in mortgage lending and in foreclosures is clear; the reasons for these disparities are less clear. The complexity of the issue should not be underestimated. We cannot ignore economic factors, but neither can we ignore a history of

¹ James Campen, Borrowing Trouble VII: Higher-Cost Mortgage Lending in Boston, Greater Boston, and Massachusetts, 2005, at 6-8.

² Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "The 2006 HMDA Data," forthcoming in the Federal Reserve Bulletin, at 41.

³ Id., at 36.

housing discrimination and resulting segregated housing patterns, imbalanced and unequal access to financial services, and discriminatory lending practices.

The Federal Reserve's analysis controlled for certain economic and lender factors in finding that racial and ethnic lending disparities remained, but could not, due to the limits of HMDA data, control for all factors, such as credit scores. Some lenders and analysts have suggested that credit scores may be the best variable for predicting whether a borrower receives a high-APR loan. At this time, however, it is not possible to test the lenders' hypothesis that credit scores, rather than race or ethnicity, are the root of racial disparities, because HMDA data does not include information on borrowers' credit scores. We cannot rule out the possibility, as the Federal Reserve's analysis of the 2006 data acknowledges, that the disparities in the HMDA data "may reflect discriminatory treatment or other actions by lenders, including marketing practices."⁴

To help illustrate that real people lie behind the numbers in the HMDA data, let me reference a case that we filed last week in Superior Court in Boston against Fremont General and Fremont Investment & Loan, a national mortgage lender that was particularly active in subprime lending in Massachusetts in recent years. Fremont originated approximately 15,000 loans to Massachusetts' borrowers since 2004. As set forth in our Complaint, Fremont used a network of brokers and sales people to sell unduly risky loans that were designed to fail, including loan products with 100% financing, stated income loans and adjustable rate mortgages with dramatic increases in monthly payments after two or three years. Borrowers were qualified for adjustable rate mortgages based upon the initial "teaser" lower interest rate, without regard to their ability to pay the higher, adjustable rates which would increase every six months.

⁴ Id.

One Fremont customer lives in Dorchester and is a single mother of three children. A mortgage broker steered her to Fremont to finance the purchase of two multi-family homes. Fremont approved her for two loans, despite the fact that her total monthly income was only \$1,800. Her broker promised her that she would be able to reduce her mortgage payments through refinancing, and induced her to sign a blank loan application which the broker used to submit false information about her employment and monthly income. She was discouraged from hiring legal counsel by her broker, and she learned for the first time at closing that her monthly mortgage payments would be more than \$7,000 per month and could adjust from her initial interest rate of 7.65% up to 14.65%. Although Fremont obviously should have known that she did not qualify for the mortgages, Fremont paid the broker \$7,024.00 for arranging her mortgages. Fremont then passed this cost on to her.

Another Fremont borrower, who resides in Dorchester and purchased a multi-family house by taking out a Fremont loan. Although she filled out a loan application listing her salary of \$2,000 per month, she then received letters from Fremont stating her mortgage payment would be more than her entire monthly salary. She called her broker to say that she could not afford the mortgages and did not want to go forward. But her broker told her that the letters were in error and her monthly payments would be lower. When she attended the closing and saw the same monthly figures listed, she initially refused to sign the papers. But Fremont's counsel told her that it was too late to back out and she would owe the money to Fremont anyway. In her efforts to pay her mortgages, she depleted her entire life savings and then lost her home to foreclosure.

These are just two of the thousands of people in Massachusetts who have lost their homes and their savings as a result of irresponsible, and in some cases, illegal, lending practices in recent years. We will continue to aggressively enforce the law against lenders who engaged in

unfair, deceptive, or illegal practices. By enforcement of the state's Consumer Protection Act, G.L. c. 93A and its regulations. In addition to violating Chapter 93A, discriminatory lending practices are actionable under various state and federal laws, including, the federal Fair Housing Act and the Equal Credit Opportunity Act, as well as the Massachusetts fair lending statute, G.L. c. 151B, § 4(3B).

In that regard, I would like address the issue of federal preemption, and respectfully ask the Committee to consider whether a return to the well-tested dual enforcement roles of the states and the federal government would better serve both consumers and responsible lenders. Increasingly, the traditional and critical role of the states in ensuring fair lending is challenged by those who argue that that role is preempted by federal law, and that federal agencies such as the Office of the Comptroller of the Currency (the "OCC") or the Office of Thrift Supervision will ensure compliance with consumer protection and fair lending laws.

For example, in 2005, in response to an investigation by the New York Attorney General into lending practices by national banks operating in New York, the OCC filed a lawsuit against the Attorney General to stop that enforcement effort.⁵ The OCC and the national banks claimed, and the federal district court found, that the state Attorney General was preempted by the National Bank Act⁶ and the OCC's implementing regulations⁷ from pursuing an enforcement action against national banks. The court enjoined the New York Attorney General from issuing subpoenas or inspecting books and records of any national banks in connection with an investigation into residential lending practices, and prohibited the state Attorney General from

⁵ Office of the Comptroller of Currency v. Spitzer, 396 F.Supp.2d 383 (S.D.N.Y. 2005).

⁶ 12 U.S.C. § 484(a)

⁷ 12 C.F.R. § 7.4000 et. seq.

“instituting actions in the courts of justice against national banks to enforce state fair lending laws.”⁸

This year, the Supreme Court ruled in Watters v. Wachovia⁹ that states may not exercise any visitorial powers over national banks or operating subsidiaries of national banks.¹⁰ According to the Court, the National Bank Act¹¹ and the OCC regulations promulgated under that Act¹² preempt the states from examining national banks or their operating subsidiaries, inspecting books and records of national banks or their operating subsidiaries, and enforcing compliance with any applicable federal or state law concerning activities of national banks or their operating subsidiaries that are authorized or permitted by federal banking law.¹³ Of the top five lenders by foreclosure petition in each of the neighborhoods of Dorchester, Roxbury, Mattapan, and Hyde Park, all but one (Fremont Investment & Loan) are nationally chartered banks. In order to best address the impacts of the subprime lending and foreclosure crisis, and to prevent the recurrence of these practices in the future, we ask that this Committee give serious consideration to restoring the effective dual federal and state enforcement role by limiting federal preemption.

Finally, we applaud Congressman Frank’s efforts to expand reporting under HMDA. Credit scores are one of several variables that logically should be reported by lenders to the Federal Reserve Board for inclusion in the HMDA data. Banks are required to report interest rates only if they are above the high-APR threshold. As a result, the public has not information about how interest rates below the threshold are distributed. Banks do not report points,

⁸ Id. at 407-8.

⁹ Watters v. Wachovia Bank, N.A., 127 S.Ct. 1559 (2007).

¹⁰ Watters, 127 S.Ct. at 1568, 1572.

¹¹ 12 U.S.C. § 484(a)

¹² 12 C.F.R. § 7.4000(a)(2)(2006) et. seq.

¹³ Watters, 127 S.Ct. at 1568-9, 1572-3.

prepayment penalties, loan-to-value ratios, or debt-to-income ratios. All of these variables and more could help enforcement authorities to better understand the critical issue of racial and ethnic disparities in mortgage lending.

Racial and ethnic disparities in mortgage lending data are troubling, and we cannot be complacent about what that data may mean. Moreover, we must act now at both the state and federal level to address lending abuses that have caused such damage to all Americans. I will continue to do so, and I appreciate that Chairman Frank and members of this Committee are considering additional federal action as well. Thank you again for the opportunity to testify today.